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TAGS: ECON EFIN PGOV PREL PA VZ
SUBJECT: PARAGUAY-VENEZUELA ENERGY AGREEMENTS

Classified By: DCM Michael J. Fitzpatrick; reasons 1.4 (b) and (d).

¶1. (C) SUMMARY. Paraguay signed April 1 in Caracas a food-for-oil Memorandum of Understanding (MOU) with Venezuela. The MOU includes Paraguay's agro technology transfers to Venezuela, and an option for Venezuelan public and private investment in the sector. Venezuelan Foreign Minister Maduro will visit Paraguay April 11-12 to finalize trade volumes under the MOU. Paraguay,s Petropar also renewed April 1 a diesel supply contract with Venezuela's PDVSA through December 2008 under terms that allow Petropar to pay PDVSA for diesel with up to 30 million USD worth of long-term bonds from the Paraguayan Agency for Financing and Development (AFD). PDVSA and Petropar also renewed their commitment to invest in the upgrades and expansion of Petropar's Villa Elisa refinery and a diesel storage facility. The April MOU is backed by a 2004 energy cooperation agreement signed between the two countries, and ratified by Paraguay's Congress in 2005. The concrete benefits of this new MOU for Paraguay are unclear. Paraguay is already exporting the agro commodities listed in the MOU with well-established outlets to international markets. With elections April 20 and a new administration August 15, the Duarte administration's decision to move forward now with the MOU, in the midst of a tight presidential race, seems targeted to satisfy Duarte's political gain more than any economic objective. END SUMMARY.

Paraguay's Food-for-Oil MOU with Venezuela

¶2. (U) Paraguay's Foreign Minister Ruben Ramirez signed April 1 in Caracas a food-for-oil Memorandum of Understanding (MOU) with Venezuela's Foreign Minister Nicolas Maduro. The MOU, similar in structure and terms to agreements Venezuela signed with Brazil and Argentina, formalizes the mechanism for Paraguay to trade beef, soy, maize, rice and milk products for Venezuela's diesel and oil-related products. The MOU also solicits Paraguay's know-how and technology to assist Venezuela in the production of soy, beef and milk products, and contemplates efforts to increase Venezuela's public and private investment in Paraguay's agro infrastructure. A permanent bilateral commission comprised by the signing countries' foreign affairs, agriculture, and commerce ministries will be responsible for the administration and implementation of the MOU. The parties agreed that Venezuelan Foreign Minister Maduro along with Venezuela's Ministers of Agriculture and Commerce will visit Paraguay April 11-12 to finalize trade volumes under the MOU.

A NEW CONTRACT AND RENEWED COMMITMENTS

¶3. (U) During Minister Ramirez's trip to Venezuela, Petropar's President Alejandro Takahasi renewed with PDVSA's President Asdrubal Chavez a diesel supply contract (the current contract is set to expire on June 2008) from June to December 2008. The renewed contract stipulates that Petropar will pay PDVSA for the supplied diesel with up to 30 million USD worth of long-term bonds issued by the Paraguayan Agency for Financing and Development (AFD). AFD President Hilton Giardina also accompanied Minister Ramirez. (NOTE: Giardina announced April 4 that AFD is planning a bond issue of 30 million USD structured under the financing terms offered by PDVSA. END NOTE). PDVSA also renewed its commitment to invest in the upgrade and expansion of Petropar's Villa Elisa refinery and a diesel storage facility. Petropar-PDVSA joint ventures were highlighted as the principal legal vehicles to realize the investments.

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AN ENERGY COOPERATION AGREEMENT LEGALLY BACKS THE MOU
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¶4. (U) This new MOU is an extension of the 2004 energy cooperation agreement signed by Paraguay's President Nicanor Duarte Frutos and Venezuela's President Hugo Chavez Frias. As part of that agreement, PDVSA agreed to supply up to 18,700 barrels per day of diesel at market prices or its equivalent to Petropar (roughly 70 percent of Paraguay's total demand). PDVSA also agreed to do a feasibility study to upgrade and expand Petropar's Villa Elisa refinery to refine Venezuelan oil. The agreement stipulated short and long term credit arrangements for Petropar's purchases. Under the agreement, Petropar is allowed to pay the equivalent of long-term debt payments contracted with PDVSA with in-kind payments (services and goods). Also as part of the agreement, Petropar and PDVSA signed a letter of intent to form joint ventures to explore, commercialize, and refine crude in the region. Congress ratified the agreement in early 2005 and Petropar signed its first six month supply contract (from June to December 2005) with PDVSA, followed by subsequent contracts at six months intervals.

THE SUPPLY RECORD UNDER THE AGREEMENT

¶5. (SBU) PDVSA supplied roughly 65 percent of Paraguay's diesel in 2005, but in 2006 the volumes declined to 50 percent. In June 2006, the contract with PDVSA expired, and Petropar was late in renewing the legal documentation with PDVSA, leading to a three-month diesel shortage in Paraguay. Petropar procured the shortfall in the open market, mostly from Brazil's Petrobras. In 2007, Petropar procured roughly 150 million USD worth of diesel from PVDSA, about 40 percent of Paraguay's diesel demand. (NOTE: PDVSA does not sell directly to Petropar. Under a service agreement between Brazil's Petrobras and PDVSA, Petrobras delivers its diesel to Petropar on behalf of PDVSA. END NOTE.)

COMMENTS

¶6. (C) The concrete economic benefits of the new MOU are unclear, as Paraguay is already exporting the agro commodities listed in the MOU. These private agro exporters already have well established international market outlets, including Venezuela (Brazil, Uruguay, Chile, the US, and the EU are more prominent markets). It is not clear what the private sector incentive is, if any, to participate in a mechanism to trade commodities for oil, especially when it appears that the intermediary would be Petropar. The GOP could choose, with the help of Venezuela, to use public funds to invest in its own agro production to trade with Venezuela. However, this scenario would likely face severe opposition from the private sector, something that the current and new administration would likely want to avoid.

¶7. (C) COMMENT CONTINUED: With elections April 20 and a new

administration August 15, the Duarte administration's decision to move forward now with the MOU, in the midst of a tight presidential race, seems targeted to satisfy Duarte's political gain more than any economic objective. The MOU does not appear to relate to economics, but to domestic and regional politics. Duarte wants to secure votes, and Petropar is an important tool of the Colorados' patronage system. With the exception of AFD's announcement of a long-term bond issue (something that Paraguay's capital markets really need) the MOU offers no other obvious economic benefits for Paraguay. END COMMENT.

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